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January 8, 2014

Mr. William Coen  
Secretary General  
Basel Committee on Banking Supervision  
Centralbahnplatz 2  
CH-4051 Basel  
Switzerland

**Re: Guidelines BCBS Corporate Governance Principles for Banks, Consultative Document**

Dear Mr. Coen:

The Institute of International Finance (IIF) appreciates the opportunity to comment on the Basel Committee on Banking Supervision (BCBS) consultation on the Guidelines: Corporate Governance Principles for Banks. The IIF strongly supports the BCBS' focus on this important area, and welcomes the initiative of these updated Guidelines.

**General Comments**

In particular, we are supportive of the need to further incorporate new concepts and developments that have emerged since the Guidelines were first produced. For example, we note and support the effort to reflect the Financial Stability Board's (FSB) *Principles for An Effective Risk Appetite Framework* into the revised Guidelines. Concepts in the areas of risk culture, risk governance, and risk appetite are essential elements in the governance of banks and should be duly reflected in BCBS Guidelines.

Within these proposed Guidelines, one area that we feel particularly warrants further examination is the delineation of responsibilities between boards and management. There are several areas where the Guidelines may create some confusion, and imply an over-reach of the board with respect to the responsibilities that properly reside with management. Many of our specific comments and suggestions deal directly with this theme.

We understand that directors are today expected to have enhanced oversight responsibilities, acquire greater expertise, dedicate greater time to their responsibilities and in general, adopt a more comprehensive, richer and fuller oversight responsibility and involvement in financial firms. At the same time, we believe it is of fundamental importance to maintain a clear and adequate delineation between the responsibilities of senior management (in general the C-suite of the firm and other senior roles) for the execution of the business, and the oversight responsibilities of the board of directors.

We propose that this area requires further analysis and refinement, in order to prevent the blurring of what are important lines between the board's oversight and senior management's operation of the firm. In several instances in the proposed Guidelines, we observe that these distinct responsibilities are either

mixed or, in our view, erroneously assigned, and we believe that this requires detailed further reconsideration. The IIF stands ready to support the BCBS in such further analysis.

We believe that the Guidelines' approach to governance structures within banks should be a proportionate one, and that the optimal structures for large, complex institutions might not be appropriate for smaller banks. Our impression is that this is reflected in some of the proposed Guidelines, but not others, and we have made suggested refinements to reflect this as a consistent theme for these Guidelines.

Also meriting further and careful BCBS analysis are the proposed formal definitions of "Duty of Care" and "Duty of Loyalty". While the content of the definitions may not appear problematic, attempting to suggest a global definition can interfere with principles of sovereignty, as well as creating issues in several jurisdictions, where they may be resisted on legal grounds. Where such concepts are already defined at law and accompanied by a long background of case law precedents (and indeed serve as a core concept of corporate law), it may be more judicious to refrain from introducing legal definitions, and refer instead to the relevant local jurisdictions. Concurrently, these definitions are also likely to be problematic for civil law jurisdictions.

We also note that these Guidelines make very few references to accounting and financial information (and thereby, the role of a bank's finance function). We consider that both financial and accounting data are fundamental tools enabling sound corporate governance to develop, conveying relevant and robust information to stakeholders and informing various levels of the corporate governance framework.

Risk appetite and strategy, for example, will be significantly informed by financial data; capital and liquidity are assessed on the basis of accounting and financial information, and prudential ratios are prepared and monitored by the finance function. Consequently, we recommend that given the importance for banks to maintain a robust finance function, responsibilities for accounting and financial data should be mentioned throughout the Guidelines, in a way that is consistent with other BCBS guidance and principles, such as the *Principles for Effective Risk Data Aggregation and Risk Reporting*.

We have structured our response with a very specific listing of the terms and phrases that we suggest refining, which we hope is helpful in taking this forward.

In summary, our response has identified parts of the proposed Guidelines which require some additional clarity, as well as cases where there may be conflicts with existing BCBS rules, current FSB and OECD proposals, or legal jurisdictional issues. We are pleased to support the initiative of these Guidelines, and we are committed to supporting the BCBS in progressing further analysis and refinements to deliver an enhanced final outcome.

## **Specific Comments**

### **Principle 1: Board's overall responsibilities**

We welcome the initiative to set out the fundamental responsibilities of boards, as well as the aspirational risk culture that firms should be working towards. There has been considerable progress made throughout the industry on embedding a focus on risk appetite and enhanced risk culture, and we hope that these Guidelines can help establish a framework that effectively serves to share leading practices in this regard.

We support the focus on the four sub-sections of this Principle ('Board's overall responsibilities'; 'Corporate culture and values'; 'Risk appetite, management and control'; and 'Oversight of senior management'), although we have identified some areas where the proposed wording could be refined or clarified.

In particular, we note (and support) the comments in this Consultative Document's Introduction that "a primary objective of the revision is to reinforce the collective oversight and risk governance responsibilities of the board," and we feel some parts of the wording could be honed so as to be consistent with this statement. We agree that boards have an oversight role, but see a risk that some of the document's text could describe or imply a role that over-reaches the role of management in firms' day-to-day operations.

Accordingly, our specific comments and suggestions are as follows:

#### *Responsibilities of the Board*

- Paragraph 20: it may be necessary to clarify the intended meaning of the phrase "ultimate responsibility." As currently worded, it suggests an all-encompassing involvement across the areas noted – and while the board has overall accountability, the responsibility for the implementation of acceptable practices in these areas accumulates in senior management. We feel this paragraph should place a greater emphasis on boards' oversight role, in line with the approach identified by the Principle's opening statement.
- Paragraph 22: whilst boards have a "duty of care" and "duty of loyalty" to the firm, such duties are separate and distinct from responsibilities for day-to-day management that reside with senior management. The second sentence of paragraph 22 is broadly drafted and could be interpreted to require the board to take a more expansive, and potentially open-ended, involvement in a range of day-to-day management responsibilities as part of the discharge of their duties. We do not believe that this is intended and would seek to preserve the appropriate delineation of board duties, as distinct from senior management responsibilities.
- Paragraph 23: to recognize the distinction between board and management responsibilities, the phrases "the board should establish" or "the board should take the lead in establishing" could be expressed as "the board should oversee and approve senior management's establishment", in relation to matters such as business objectives and strategies". Again, we believe that the emphasis on the oversight responsibilities of the board is essential.
- Paragraph 23, bullet 2: the proposal that a board should "establish" corporate culture is open to misinterpretation, given the concept of "culture", and what the notion of "establishing" this might mean. We suggest that this be refined so that the board oversees the establishment of the "desired" culture by management, and that management (who understand the granular details of the organization of the bank) takes the necessary efforts to promote and embed this throughout the organization.
- Paragraph 23, bullet 7: where the board has responsibility to select and oversee the performance of "senior management," it should be clarified that this refers to positions such as CEO or CRO, for instance, so that this is not misinterpreted more broadly.
- Paragraph 24: we suggest changing transactions to "material transactions with related parties" so that a materiality test is introduced. We also suggest the opening to the sentence is revised to state that "The board should ensure that management has a framework for review of material transactions...."

#### *Corporate culture and values*

- Paragraph 27: whilst we support much of the sentiment, we note that a corporate culture is particularly difficult to demonstrate, and we would recommend removal of the word "demonstrated" from the opening sentence. This is of particular importance since undoubtedly many jurisdictions are likely to adopt a compliance-driven approach to these Guidelines, within which a duty to "demonstrate" can result in insurmountable compliance expectations. We note also that there are foreseeable legal implications and unintended consequences, especially for common-law jurisdictions.

- Paragraph 28: the phrase “the board should take the lead in establishing” should be expressed as “the board should reinforce the corporate culture and values as established by management.”
- Paragraph 29: we support the sentiments expressed regarding codes of conduct and ethics. For clarity, we reiterate our understanding that it is not an expectation of boards to control the practical aspects of the individual behavior of all employees of the bank.

#### *Risk appetite, management and control*

- Paragraph 33: we wish to clarify that the board should oversee the development and approve a risk appetite, but the responsibility for “developing” should be with the bank’s senior management.
- Paragraph 36: in our view, the Guidelines could be clarified so that there is no room for confusion as to whether a single risk management framework should cover both risk and compliance, as is currently drafted in paragraph 36. It should be clear that banks may reasonably have separate frameworks for each that work together to provide the second line of defense, for instance. In the interests of the guidance being appropriate and proportionate, we propose that the wording take this into account.
- Paragraph 37: we welcome the flexibility for banks to develop the structure of their three lines of defense, and we agree with the notion that regardless of their structure, the responsibilities for each line of defense should be well defined and communicated.
- Paragraphs 38-41: the aforementioned FSB *Principles for An Effective Risk Appetite Framework* has descriptions about first and second lines of defense. The revised BCBS principles should be aligned to those in the FSB’s report in the interest of maintaining regulatory consistency, and to avoid any potential confusion.
- Paragraph 40: we propose that the wording in the Guidelines is changed so it reads that the board does not have to review all compliance policies (as could currently be inferred from the text). Senior management should be permitted to use their judgment in determining which key policies need to be reviewed by the board including those obliged by regulatory requirements and those that are deemed to be critical to the bank. We suggest “senior management in conjunction with the board will determine which policies need to be reviewed by the board including those that are required to be approved by the board due to regulatory requirements and others that are deemed to be critical to the bank” is included in this paragraph.
- Paragraph 42: we support the intent of regular reviews of policies and controls by the board with senior management and the heads of risk management, but feel this should be subject to a materiality threshold. Consequently, we would propose inserting the word “key” before “policies and controls.”

#### *Oversight of senior management*

- Paragraph 43: this could imply that the board should select key members of senior management and the heads of the control functions only, whereas in practice they also nominate others. For clarity, we propose inserting the wording “and others as appropriate” at the end of the sentence, and removing the word “other” from earlier in the sentence.
- Paragraph 44: we also suggest removing the wording “regardless of financial gain or loss,” as this may add confusion. An alternative phrasing to be considered could be “under all circumstances”.
- Paragraph 44, bullets 5 & 6: where the appropriateness of senior management’s knowledge and expertise is discussed we would suggest replacing the word “ensure” with “seek assurances” (on each of these two bullets), to better reflect the limits of board involvement. This would also indicate that the board can utilize external validation for this effect.

## Principle 2: Board's qualifications and composition

### *Board Composition*

- Paragraph 45: the use of the word "suitable" implies that the board must itself possess all the skills needed to oversee a bank: a very high standard for the skill set of the board members. This may be inconsistent with the board's ability to use external experts, and risks establishing a whole new legal standard of board "suitability," with new legal standards of care that may represent a departure from current corporate law.  
We believe that boards are already accountable (vis-à-vis corporate governance law) to test their suitability and understand whether they themselves have the right expertise, or need external support. We suggest therefore deleting "be suitable to carry out its responsibilities and" in the first part of the sentence, or otherwise revising this phrase.  
We note the later acknowledgement that the board can employ independent experts as needed, and suggest that this should be made more prominent in this Principle. This could be achieved if the second sentence of paragraph 45 was amended to say: "...independent directors and the means to employ experts outside of the board as needed."  
We also note that the representation of independent directors might be proportional with institutional scale. For some small banks, it may be appropriate that the directors are executives or employees of a parent or shareholder, being separate from the small bank's management team, but not "independent" as such.
- Footnote 12: we welcome this inclusion, as it provides more detail on nominating candidates for the board, and suggest that it be included in the main body of the Guidelines.
- Paragraph 47: we welcome this section, but would add "for example" at the end of the paragraph in bullet 1. We would also question whether experts must necessarily be "independent" in all cases, and propose to remove this requirement, as an expert working within a bank may in some circumstances be better placed to provide the necessary expertise.

### *Board member selection and qualifications*

- Paragraph 48: noting that boards are not responsible for all senior management appointments, we feel the use of the word "ensure" is too stringent in this paragraph. We suggest instead expressing this as "The board should satisfy itself that plans are in place for the orderly succession for appointments to the board and to senior management," which is as per the UK Corporate Governance Code.
- Paragraph 51: we support this statement, but believe a materiality test should be included on the grounds of applicability and proportionality. As such we recommend amending the last sentence to read "which may include notifying their banking supervisor of material issues." A board should also be free to take any legitimate actions available to it under internal policies or procedures.
- Paragraph 52: we view the proposed requirement for banks to "have in place a nomination committee or similar body" as prescriptive, and perhaps assuming a particular institutional scale. We suggest that more flexibility be accorded to recognize that smaller banks may have the board directly perform the responsibilities described in this paragraph.
- Paragraph 54: we support this statement, but it would be enhanced if the term "overall interests" was defined in the Guidelines.

We note that there are no requirements on periodicity in Principle 2, but in Principle 3 an annual review is proposed. We would welcome guidance about periodicity in Principle 2, and propose that there is a materiality test which drives the periodicity (e.g. a material change in the scope of the entity's exposures).

### Principle 3: Board's own structures and practices

Contrasting with some of the more proportionate views taken elsewhere in some of the Guidelines, the text proposed in this Principle is at times quite prescriptive, and runs the risk of imposing approaches that may not fit all types and scales of firms.

In particular, we would suggest that the Guidelines should not be prescriptive as to the relationship, responsibility apportionment and accountabilities between a bank's risk and audit committees. Rather, banks should determine their internal governance models to the extent it is appropriate for their scale and the nature of their business.

We also propose that the Guidelines should encourage and enable a flexible application/implementation within banks (which are all structured and governed differently). In particular, we note that some of the disclosure requirements may not be proportionate to small banks or subsidiaries of a banking group.

#### *Organization and assessment of the board*

- Paragraph 57: we agree that boards should carry out regular assessments of their own performance as a whole but not individual directors, and propose to add the wording "where appropriate" at the end of the first paragraph (after "individual board members"). We note that in some banks the Chairman performs this function for instance, and we believe that the overarching concept is that boards should review their performance to the extent appropriate for their circumstances.
- Paragraph 58: We suggest that the last word of this paragraph be changed from "required" to "appropriate," as it may not always be appropriate to provide such minutes to the regulator, for instance when the matter is legally privileged.

#### *Role of the chair*

In general, the role of the chair proposed within Principle 3 (Paragraphs 59-61) is very prescriptive and mandatory in nature. We support a more proportionate approach to a board's own structure and practices, and one which accepts differences in corporate governance structures. We believe the role of the chair should be commensurate to the bank's size, complexity, structure, economic significance and risk profile.

- Paragraph 60: we support the concept of checks and balances, but we believe the proposed wording is too prescriptive, and does not consider different governance models as practiced in various jurisdictions.  
Firstly, the requirement for the chair to be a non-executive director is unduly prescriptive, and we believe this should be removed. A board should have the discretion to determine its appropriate leadership structure, and various structures, such as an executive chair with a lead independent director, may be appropriate.  
Secondly, the ability and appropriateness of the board chair to serve as chair of other board committees would likely be variable to the scale and nature of each bank. To the extent that this paragraph is seeking to limit that ability in all cases, we believe that it should be applicable only to the audit and risk committees. We also note that in some jurisdictions, it is required or expected that the chair of the board will also serve as chair of the nomination committee.  
It is also noted that some banks have major subsidiaries that each have their own boards; unsurprisingly, chairs of subsidiary boards may be appropriate to chair committees of other subsidiary boards and therefore could be permitted to do so. We believe this is a normal and sound practice and should not be prohibited or limited without clear prudential goals or objectives to support such limitation.

### *Board committees*

- Paragraph 64: the proposed requirements may conflict with different local regulations and laws. Further analysis is required, and possibly some explicit exceptions noted.
- Paragraph 65: we propose that the wording “of their deliberations and decisions” is deleted from the first sentence in the interests of flexibility for firms to document their meetings appropriately.
- Paragraph 66: whilst the intent of limiting executives from chairing a committee is understood at a group level board, for those banks with subsidiary structures, it may be appropriate for an executive to chair a committee of a subsidiary board. If this paragraph is maintained, we would suggest limiting its scope to group level boards and committees, in the interest of encouraging flexibility of approaches in the banking sector and providing a means of accessibility for talent to participate and lead board committees. We would also be grateful for clarification that this paragraph does not refer to and include executive committees or group management boards.

### *Audit committee*

- Paragraph 67, bullet 5: we propose that the financial and audit experience (skills and competencies) should not be limited to the banking sector, but to also consider other relevant experience, such as those derived from other financial services sectors. We suggest that the last bullet reads “should include members who have experience in audit practices and financial literacy.”
- Paragraph 68, bullet 7: where this point assumes that third-parties provide an opinion on design and effectiveness of “the overall risk governance framework,” we believe that this is too prescriptive, in that it could be one of the risk committee’s functions, for example.

### *Risk committee*

- Paragraph 72: the inclusion of compliance risks among the risk committee’s responsibilities may create a conflict for those banks where compliance risk is currently overseen by audit committees. This is the case in many companies, and is an NYSE requirement for audit committees.
- Paragraph 74: we believe the requirements for joint audit and risk committee meetings are quite prescriptive, and that overlapping members and/or the requirement for committee chairs to liaise should be viable alternatives drafted into the text. We propose that this paragraph is amended on the basis that meetings between the risk committee and other committees with risk-related oversight may be facilitated between the chairs of such committees, as appropriate.

### *Other board committees*

- Paragraph 76: as with paragraph 72 above (under ‘Risk committee’), this may create a conflict for those banks where compliance risk is currently overseen by audit or other board committees. This is the case in many companies and this is also an NYSE requirement for audit committees.
- Paragraph 76, bullet 1: we note that some jurisdictions do not require a nominations committee to recommend senior management appointments. We suggest revising the opening part of this bullet, to provide flexibility and recognize that whilst nomination committees may perform this function, it is not universally the case.

## *Conflicts of interest*

- Paragraph 82: we believe this paragraph should be replaced by a more generic requirement that board members should be aware of the situations which might create potential or perceived conflicts of interest in their role as directors. We believe the firm should have flexibility to set a conflict of interest policy for the entire firm that is applicable to the board as well, without having to formally prepare a board-specific conflict of interest document. We would however expect to see specific examples of potential conflicts more appropriately covered by training or as part of the established processes for identifying potential conflicts, for instance. Accordingly, we propose to replace the text with “board members should be aware of the situations which might create potential or perceived conflicts of interest in their role as directors.”
- Paragraph 83: we disagree with the concept of public disclosure of conflicts of interests and would recommend that it is deleted from the text; however we do think that it is appropriate for banks to keep supervisors informed where there are material conflicts.

## **Principle 4: Senior management**

We support the intent of Principle 4, whilst noting items where the wording of the proposed Guidelines may diverge from definitions and requirements set out in other BCBS documents.

- Paragraph 86: we believe that the definition provided of “senior management” is different to that in BCBS195 Footnote 9, and we propose that they are made consistent.

## **Principle 5: Governance of group structures**

We note that some of the proposals in this Principle are more highly prescriptive than in other parts of these Guidelines, and we believe that a prescriptive approach to the banking sector is inappropriate. It can be problematic to set a principle that applies to all subsidiaries because not all parent-subsidiary relationships are the same, and some are driven by regulation. We believe that groups should have the flexibility to determine their own approaches to corporate governance

Further, we note that paragraphs 94 and 95 imply that a centralized approach to corporate governance is required, whereas we believe that this preference shouldn't be prescribed in regulation. We recommend that there is flexibility to pursue the optimal governance structure for each firm's circumstances, ensuring sound and prudent group-wide governance.

## *Parent company boards*

- Paragraph 94: we believe there is ambiguity in requiring the parent company board to “exercise oversight” and to “respect...responsibilities” at the same time; in practice, this could be a contradiction. To help relieve this, we propose to delete the word “might” from the second sentence in the text. We also recommend that paragraph 94 is made to be reflective of the fact that many banks operate on a cross-border basis. To this effect, we believe that the first sentence in paragraph 94 should read “including (cross-border) subsidiaries”.
- Paragraph 95: this paragraph is highly prescriptive, in a way that may be more appropriate for senior management responsibilities (with board oversight). The introductory words to the first six bullets (“establish”, “define”, “assess”, “ensure” and “approve”) are each more akin to accountabilities of senior management. This appears to conflict with the opening statement of paragraph 94, which refers more to a parent board's oversight of the group structure. We propose that for the paragraph's opening text, “In operating within a group structure” be replaced with “Assuring that all of the management policies are in place, the board of the parent company....”

- Paragraph 95, bullet 8: continuing the theme of delineation between board and management responsibilities, our view is that the parent board should maintain oversight of material home and host country regulatory relationships, which are maintained by senior management.

#### *Subsidiary boards*

- Paragraph 96: where the wording specifies “subsidiary bank,” we propose that this be amended to “subsidiaries,” recognizing that not all subsidiaries are banks (e.g. bank assurance entities).

#### *Complex and opaque structures*

- Paragraph 99: where this paragraph refers to risks that can arise when a bank “establishes structures on behalf of customers,” we would appreciate clarification on what this refers to (we don’t feel that Footnote 18 provides this).
- Paragraph 100, bullet 3: we agree that there should be a set policy for approving new legal entities and monitoring activities, but the process should not necessarily be centralized.
- Paragraph 100, bullet 4: it should be clearly stated that material risks are relative to the organization as a whole, not necessarily measured at the legal entity level. To look at each material risk as it may exist to a given legal entity would be very burdensome especially where a bank has many very small legal entities that are individually immaterial to the total organization. We suggest replacing the word “adequate” with “appropriate and proportionate.”
- Paragraph 101: we support the intent of periodic formal reviews, but feel that the word “independent” is unclear and unnecessary.
- Paragraph 102: we agree that boards should, when appropriate, understand and review the policies and procedures regarding legal entity structure, as outlined in Paragraph 100. However we propose that senior management is the most accountable as an appropriate party to discuss such policies and strategies with home and host country supervisors. Notably, paragraph 100 indicates that senior management may take the lead in implementing such policies and procedures, and we recommend that paragraph 102 reflect this also.

### **Principle 6: Risk management**

The critical importance of a strong and independent risk management function is well acknowledged and supported throughout the industry, Principle 6 is a welcome re-affirmation of this, though with some specific points that warrant refinement. As with Principle 1, we notice some points that could create confusion as to the delineation of roles between the board and senior management.

- Paragraph 103: the opening text well articulates the oversight role of the risk management function, which we wholeheartedly endorse. However, the first bullet-point then refers to the risk management function’s role as “identifying” material risks, which may cause confusion in the context of the three lines of defense model.
- Paragraph 103, bullet 3: the text implies that the board performs the firm-wide implementation, whereas we believe the board oversees the implementation, performed by the senior management. We recommend revising this bullet accordingly.
- Paragraph 105: we propose to delete Footnote 19; whilst we note the observation that this makes, we believe its inclusion could be interpreted as an overly prescriptive direction on staff development and appointments.
- Paragraph 107: this paragraph also describes the role of the board as one of developing and implementing, rather than oversight, whereas that responsibility should lie with senior management (in this case, the Chief Risk Officer). This could be clarified by editing the text to read “the CRO is responsible for supporting the board in its oversight and approval of the bank’s risk appetite and risk appetite statement”.

## Principle 7: Risk identification, monitoring and controlling

We support the core content of this Principle, whilst also wishing to highlight where alignment with other BCBS Principles could be enhanced:

- Footnote 21: we note the reference to BCBS239 (“Principles for effective risk data aggregation and risk reporting,” January 2013), however, some elements of this Principle appear to differ with BCBS239. We recommend further analysis, and alignment with BCBS239, for consistency.
- Paragraph 112: we agree that banks should have a method to identify and assess hard-to-quantify risks, such as reputation risk, but seek acknowledgement of the challenge in measuring such risks. As such, we suggest that the word “measure” be removed from this paragraph, perhaps replaced with the word “assess.”
- Paragraph 113: for greater clarity, we suggest that the term “other measures” could be replaced with “other means of identification.”
- Paragraph 124: we note that for mergers and acquisitions, there is often a very small due diligence group. We agree that potential post-merger risks should be identified and reported to the board, but given the select groups involved and the necessary confidentiality, there needs to be flexibility as to who specifically might perform this function of escalating to the board.

## Principle 8: Risk communication

We would like to see both materiality and appropriateness tests in Principle 8.

- Paragraph 125: while we support the sentiment of this paragraph, we believe it is important to avoid any possible misinterpretation that “all” information should be communicated “throughout the bank” as is currently proposed. We suggest that this text is reworded to include “to an appropriate audience” or similar.
- Paragraph 127: we support the practice of escalating ad hoc information, and welcome this being highlighted within the Guidelines. However, we see a greater challenge in requiring “suitable policies and procedures” for this, noting that the very nature of ad hoc information does not lend itself to a policy format. We support this paragraph, but suggest removing the last sentence.
- Paragraph 130: we suggest removing the words, “avoid organizational silos” and instead change the language to say “effective mechanisms should be established to allow for communication and information sharing between different organizational groups”. We also note that the sharing of information can sometimes be impeded by regulatory requirements, and we would suggest including the statement “insofar as possible due to regulatory constraints” in the last sentence.
- We recommend that there is a requirement in Principle 8 to communicate risks across the bank between first, second, and third lines of defense, in addition to those described up to the board.

## Principle 9: Compliance

- Paragraph 131: this states that the compliance function is part of the second line of defense; however, this is not the case in all banks. We propose to amend the first sentence in paragraph 131 to “an independent compliance function is a key component of a bank”. We also note that compliance is everyone’s responsibility, and should be owned by the business as much as the compliance function itself, a point that could be added to this paragraph.
- Paragraph 132: we are extremely supportive of this paragraph and agree that compliance starts at the top. This is an important part of the Guidelines, in that firms should observe the spirit as well as the letter of the law.

- Paragraph 133: we believe this should be amended to read “The bank’s senior compliance management is responsible...” to pinpoint accountability and to ensure consistency.
- Paragraph 135: we note that it is not always the compliance function that is accountable for informing the bank about the laws and regulations, although we agree that the compliance function would be the most appropriate function to oversee this activity. We would propose amending the wording such that this paragraph begins “The board should be advised about compliance, regulations, rules and standards...” We would also appreciate clarity as to what is intended by the term “compliance laws”.
- Paragraph 136: we believe that this text should be refined to read “The compliance function is independent from business management....”
- Paragraph 138: where this lists areas of special focus for compliance, we suggest that both “the product approval process” and “sourcing processes” should be added.

### **Principle 10: Internal audit**

We welcome the reference to internal audit in its role as the third line of defense in this Principle, noting it only has a brief reference in Principle 1, if it is fully aligned and consistent with the FSB approach.

### **Principle 11: Compensation**

Principle 11 would seem to indicate that the board should review, approve and oversee the bank’s entire compensation policy. Again relating the theme of the delineation between board and management responsibilities, we see it that the board should be reviewing the bank’s compensation plan, processes and outcomes. We agree the board should approve broad compensation principles (e.g. claw-backs), but there should not be a requirement for a detailed, prescriptive policy at every single level of the bank and we propose that conceptually more flexibility is applied.

Accordingly, we recommend replacing the references to “policy” in this Principle with “bank’s compensation plan, processes and outcomes to the extent that a bank reviews in hindsight whether people are paid appropriately, risk events, and what actions they took.”

- Paragraph 144: we agree (and emphasize) the description of the board’s responsibility as providing “overall oversight of the compensation system,” noting that this oversight may be provided via compensation committees. We also agree that the board “should regularly monitor and review outcomes,” noting that such activity should be proportional, and subject to materiality thresholds.
- Paragraph 148: we note that compensation for risk and compliance functions should be competitive in relation to the business units, in order to avoid a negative selection effect, and to promote the equal importance of these functions to the bank’s success. In this way, we propose that the first sentence of this paragraph should be refined to include the phrase “compensation should be competitive, and determined independently of any business line overseen....”
- Paragraph 150: we suggest that the second sentence be revised to state that “compensation is adjusted to take into account the full range of known risks as well as realized risks”. For clarity, we would not take this to an extreme of requiring a bank to conduct scenario analysis to determine if there are unknown, potential risks that should impact compensation.
- Paragraph 151: we suggest adding the words “take action as soon as practicable,” as it is more practicable to hold back compensation in the current year than to try and recoup compensation that has already been paid, in practice.

### **Principle 12: Disclosure and transparency**

The IIF and its members continue to support initiatives for increased transparency and disclosure, to the extent that other laws and agreements allow. As such, we support this principle, but wish to highlight

cases where the disclosures required for corporate governance could conflict with non-disclosure agreements based on acquisitions and agreements founded on local laws.

We support enhancing Pillar 3 and the work of the Enhanced Disclosure Task Force (EDTF), and note that these Guidelines should align with those other initiatives.

- Paragraph 154: we believe that the disclosure requirement described should not necessarily apply to subsidiaries, recognizing legal structure and jurisdictional considerations. As such, we propose that the text be amended to reflect this.
- Paragraph 156: where the disclosure of “complex” activities is required, it would be beneficial if the BCBS could define this term. We suggest such a definition could be a factor of materiality, in keeping with the Guideline’s overarching theme of proportionality, which we support.
- We also recommend that this section be written within the context of the Pillar 3 framework.

### **Principle 13: The role of supervisors**

We support the initiative to clarify the role of supervisors in the form of this Principle.

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The IIF hopes that these comments are helpful as the BCBS considers the above proposed final changes and amendments to the Guidelines. We emphasize our support for the updated Guidelines, and for the Principles contained therein, and we are very keen to assist in the further analysis, clarification and refinement.

We welcome a close dialogue with the BCBS on this important matter. In this regard, we look forward to opportunities for formal exchange of views on this topic, either through industry outreach sessions, colloquia or symposia. As in the past, the IIF stands ready to provide opportunities for such dialogue and to provide further input and any necessary expansions or clarifications on all of our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "A. K. Quinn". The signature is written in a cursive style with a large, prominent initial "Q".